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Chuka Umunna MP
House of Commons
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Dear Chuka,

Thank you for your letter of 5th October. I note your concerns about value for money for the taxpayer in how Royal Mail will be priced in the upcoming share offering.

Value for money for the taxpayer is an absolutely key consideration for me in this transaction. Getting the right price in the transaction is in the interest of taxpayers, consumers and employees alike, as is ensuring that ownership of the Royal Mail moves smoothly to responsible investors able to take a long term, responsible approach to owning the company. The approach we are taking encompasses all of these considerations. I worry that the line you are taking on the other hand is irresponsible, simply magnifying a small minority of views which take a short term view of the flotation.

To achieve value for the taxpayer we set the price range based on extensive consultation with investors. We have also undertaken a market standard 'book building' exercise during which the Management have been communicating to investors the key highlights of the business and its future potential. This process should ensure that the price paid by investors appropriately reflects the value of the business, while creating an enduring shareholder base amongst long term institutional investors and positive aftermarket performance over the long term.

You mention in your letter the top end of the value range attributed to the business by a report published by Panmure Gordon. In any IPO there are a wide range of potential views expressed by various institutions, commentators and research analysts. Panmure Gordon is only one voice and their report notes both near term risks and opportunities. We are alert to value for money criticism and have learnt from the mistakes of previous Governments' asset sales. QinetiQ is one key example under the last Government.

Positive performance of the Royal Mail share price over the long term would be consistent with our overarching objective of developing a strong business which can protect the universal service.

It will also be of significant benefit not only to the taxpayer who will retain a meaningful stake in the business, but also to Royal Mail employees who will own 10% of the business.

You say that ours is “an unusually short timetable”, but I can confirm that the offer period is inline with other IPOs, for example the recent Direct Line share offer, and there has been no suggestion that investors have had insufficient time to consider their investment decision. In addition the extent and the length of pre-launch investor soundings has been one of the most significant ever undertaken in an IPO process.

It would be wrong to talk only about the future potential, without being transparent about risk. This is why the company has disclosed a comprehensive list of risk factors in the prospectus, which Royal Mail has ensured contains all the material information to enable investors to make their investment decision. I also feel it is irresponsible to imply that a share offering looks significantly undervalued. I think you should consider the risk that you may be influencing the decisions of retail investors. Equity investment always involves risk, particularly when the company in question is new to the market. In the light of this it is dangerous to imply that there is an easy bargain to be made.

You raise numerous questions about the company’s real estate portfolio. You will have seen that disclosures relating to Royal Mail’s property strategy are set out in the prospectus, which includes details of the three major surplus sites and confirms that there are a limited number of other sites with potential for development. It is also clear that the other sites are not readily realisable due to ongoing operational use. Investors will be using all this information in determining their view on valuation.

You quote a property value of £1bn for the three London sites without citing the source for this. However it is difficult to see how this valuation was reached given that land neighbouring Royal Mail’s 14 acre Nine Elms site recently sold at prices in a range from £10m to £15m an acre. Again, it is quite wrong to be using back of the envelope calculations which have no objective basis to speculate in public about something as intrinsically uncertain as the value of future property sales.

Whilst under Government ownership, Royal Mail has pursued a commercial strategy to ensure that its real estate portfolio meets the demands of the business and its customers, and will continue to do so following an IPO. You ask whether we have incorporated clawback mechanisms, but clawback assumes that the taxpayer is happy to gamble on possible future upside by allowing potential investors to pay a lower price for the shares today; we do not believe that this would be in the taxpayer's best interests.

The interests of taxpayers have been central to our policy for Royal Mail and these interests are not limited to the sale valuation. Our policy ensures that we are securing the future of the universal service by allowing RM to act commercially, driving value in the IPO through an extensive pre marketing exercise, and ensuring that the taxpayer can share in the future potential of the business through a retained stake.

To help us decide how best to achieve each of these objectives and to inform the price range we have been advised by our Global Coordinators as well as an independent adviser, Lazard.

There will be plenty of opportunities in the wake of the IPO to evaluate its success. I expect the National Audit Office and the Public Accounts Committee will scrutinise this transaction carefully. I am happy to give a commitment that my department will cooperate fully with any such inquiry.

VINCE CABLE

Secretary of State for Business, Innovation and Skills